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House Committee on Small Business

"Health Care Reform in a Struggling Economy:

What is on the Horizon for Small Business"

The Intersection of Health Care Solutions, Small Business

and Economic Stimulus

February 4, 2009

Thank you, Chairwoman Velazquez and Ranking Minority Member Graves, for the opportunity to testify before the House Committee on Small Business to discuss policy solutions aimed at providing small businesses and their employees with access to affordable health care. I am appearing today as Executive Director of The Coca-Cola Bottlers' Association (CCBA), which represents 73 bottlers and 87,000 employees in all 50 states. I have also previously served as President of the Association Health Care Coalition (TAHC), a coalition of trade and professional associations that is committed to improving the health care options available to their small business members and testified in 2004 and 2005 on behalf of both CCBA and TAHC before both this Committee and the Senate Committee on Small Business & Entrepeneurship on various options for solving the health care challenges facing small businesses and their employees.

I thank both of you not only for the invitation, but more importantly for your leadership and support of innovative solutions to the small business health care crisis, including your sponsorship of The Small Business Health Care "CHOICE" Act. For reasons which I will outline, I believe that the CHOICE Act will dramatically expand the affordable options available to small businesses and will make a sizable contribution toward solving America's health care challenges, probably beyond the expectations of those who may only see it as a first step toward health care reform.

Inasmuch as this is my third appearance before this Committee, I will dispense with a full recitation of CCBA's experience in providing health insurance solutions for its members. For the benefit of the new members of the Committee, I will simply summarize by saying that, like many trade associations, CCBA has struggled recently in its efforts to provide affordable health care programs for its smaller members.

Unlike many associations, however, CCBA has achieved significant success in maintaining health insurance programs for its larger members and even greater success in providing virtually every other imaginable form of insurance and employee benefits to members of virtually all sizes. This contrast between the opportunities available to groups of small business and large businesses in the health care arena, and between the success of pooling efforts for small businesses in health care and other forms of insurance and employee benefits, speaks volumes about the problems facing the small business community in finding solutions to the health insurance dilemma that they face. It also sheds light on the key questions now facing Congress, namely how to control the raging growth of the ranks of the working uninsured and underinsured in the small business work place without crippling a struggling economy, driving further unemployment or adding further stress to a federal budget deficit that should frighten all of us. To put it simply, there are too many roadblocks to finding health care pooling solutions for small businesses and too much of a gap between the opportunities available to large and small businesses. The small business community needs the help of Congress and this Committee in this critical arena.

For decades, CCBA administered two separate health care plans: a fully-pooled program for small bottlers under 100 employees; and another individually experience rated program for those bottlers with over 100 employees. Both programs were fully insured, but involved various levels of risk retention by CCBA and its members. In 2000, CCBA's small member health care plan was disbanded due to the overwhelming complexity of state small group reform laws and regulations.

As a result, quotes for our smaller member bottlers for comparable coverage increased by double digits for several years in the early part of the decade. Their only option has been to cut back on their plans, utilizing higher copays, higher deductibles, elimination of employer-supported family coverage and higher annual out-of-pocket maximums. These changes have greatly reduced employee participation rates, effectively pricing 50% of the employees out of the market for the coverage they once had. Many of our members are left with offering nothing but employee-only coverage, increasing the number of uninsured employees and/or their family members, including children.

We have been able to continue operating a CCBA-administered health plan for the benefit of our larger employer members (Coca-Cola bottlers with more than 100 employees). Our larger employer members have been able to continue benefiting from the cost-saving efficiencies of participation in the CCBA plan, with average annual premium increases approximately equal to, or in some cases less than, the market average. Our large employer program also provides stability of plan design offerings and long term carrier contracting that enables access to a consistent provider panel enabling fewer provider–patient disruptions. Moreover, our largest members, as well as the largest competitive bottlers, are able to provide high quality health care benefits at acceptable costs through the mechanism utilized by almost all large employers—self-funded single employer programs—without any assistance from CCBA.

The Economics of Small Group Insurance

This imbalance between the options available to our large and small members is reflective of the market imbalances facing large and small businesses. The implications of that imbalance become apparent upon examination of the basic economics of health insurance.

Attached to my testimony is an analysis prepared for CCBA by Mercer concerning the relative costs of the components of health insurance costs for small, medium and large employers and groups. As it shows, non-actionable claim costs (the actual amounts necessarily received by providers of medical services) are roughly equal for small, medium and large groups. Other costs, such as administrative and risk underwriting expenses, are dramatically different depending on the size of the employer or group.

Importantly, as the Mercer analysis shows, the amounts paid to providers for medical services are only slightly more than two-thirds of total costs in the small group market. In my view, any solution to the health care challenge facing small business and its employees (which is a large part of the overall health care challenge) must significantly shrink those non-provider costs, since they are not likely to be affordable to any of the players (the small business community, its employees, or the federal government and the federal taxpayer). By my estimate, those non-provider costs for small business health insurance exceed $100 billion!!! Those costs cannot be eliminated, because any form of small business health insurance will involve significant administrative costs, but surely they can be reduced.

The two components that drive the greatest disparities and the greatest incremental costs for small business (administrative costs and underwriting risk expenses) must be a central focus of any reform-based solution if that solution is to be effective. For a small group or small business, administrative costs are generally greater because the costs of setting up an insurance program, deciding on benefits, communicating benefit selections, enrolling employees, establishing a claims management process and processing rules that fit with the program benefits, etc., all tend to be fixed costs that drop on a per employee basis as those costs are spread across larger groups. Likewise, marketing costs for small group policies are extremely high because of the amount of effort necessary to reach relatively small employers and fully explain their health insurance options.

One solution to that administrative challenge, of course, is to pool smaller groups of individual employees into larger multiemployer groups under a common (hopefully stable) program to further spread those costs and reduce marketing costs. Many such plans were built in the 80s and 90s, but virtually all multi-state plans, like CCBA's pooled small bottler plan, eventually disappeared because generally well-intentioned state regulations and coverage mandates forced the plan administrators to design distinct plans and distinct claims processing rules for every state (and in CCBA's case, nearly every different small bottler participant).

If state prerogatives are to be preserved, driving somewhat higher administrative costs for small businesses that band together to create scale in their own programs, how can Congress (or the marketplace) provide the solution that will deliver competitive total costs to small groups and small employees? One frequently discussed solution is to allow a government agency or other federally sponsored organization to negotiate on a national basis on behalf of small businesses with the major insurers to achieve the best possible rates for all eligible small businesses.

That approach (which essentially involves creation of pooled market power among buyers to counteract the perceived market power among sellers and thereby eliminate any excess profits collected by the sellers) has some promise to the degree that the source of the disparity in costs for large groups and small groups is the lack of bargaining power in the hands of the small group. To the extent that the disparity is driven by higher marketing costs and true cost differences in servicing large businesses and small businesses, and not differences in insurer profitability, however, even a massive bargaining coalition of small businesses is not going to achieve major savings.

One very reasonable solution is simply to provide federal financial support to small business programs, given that a major source of their disadvantage is that federal law puts them at a disadvantage relative to large employees by exempting large single employer programs from state regulation while leaving small business subject to the same regulations even if they pool their coverage with other small businesses to create the same scale. Some form of financial support for the small business community is almost certainly necessary to create fundamental fairness in an environment in which many believe (and some states have required) that businesses should provide mandated levels of coverage to their employees. The fair choice is to support small business financially if we believe that they should provide health care benefits to their employees, but face incremental costs in doing so because of an imbalanced regulatory environment.

Insurance Markets and Risk Shifting Costs

Moreover, an effective solution to the challenges facing small business and small groups also needs to address the second other major source of cost disadvantage, namely the much larger price that small businesses pay for risk retention services provided by insurance carriers. The reasons for that disparity are fairly obvious, since insurance carriers are in the business of understanding and pricing the risks that they take and fully realize that risks get smaller and smaller as they are spread across larger and larger pools of policyholders.

CCBA has extensive experience in dealing with pricing and pooling of insurance risks, since we have been operating in the liability insurance arena throughout our nearly 100-year history. In our experience, the key to achieving savings on risk underwriting costs is to pool and retain those risks to the maximum extent possible, rather than relying on insurance markets and pricing mechanisms to mitigate those costs.

The simple truth is that insurance carriers are in the business of pricing risks to generate profits for their shareholders. That is entirely natural and is simply reflective of the appropriate behavior of any participant in capitalistic markets. To some extent, carriers are able to price those risks efficiently and still generate profits because of their ability to spread the uncertainty associated with underwriting projections over large groups of policy holders, such that the uncertainty risk is reduced.

For the business that seeks to obtain health coverage for its employees, the profit generated by the carrier in assuming part of the risk associated with writing health insurance policies is simply an additional cost. The objective of a small business employer offering health insurance is to help its employees by relieving them of a part of the burden of unanticipated health care costs that they cannot afford, while reducing in a cost effective way the risk that they are taking as employers and businessmen or women to a level that their business can potentially afford. Carrier profit, while necessary to the risk shifting bargain, is simply an additional cost.

The solution for large businesses is through self-insurance and risk retention, and virtually every large business has elected to self-insure most of its health care benefits. By doing so, the large business not only avoids paying the profit that the carrier understandably must make if it is to take on health insurance risk, but also minimizes its administrative costs by taking advantage of ERISA preemption and employing consistent plan designs that do not necessarily comply with each state's unique coverage mandates.

Our experience is that a self-insured or captive strategy works equally well for small businesses, providing that pooling of risks is available. By combining with other businesses that face similar risks (or in some case totally unrelated businesses), to form cooperatives or multi-parent captives, and then retaining as much of the risk as is reasonably possible, small businesses can reduce insurance costs by minimizing the amount of actual risk that they attempt to shift to carriers, thus reducing the profit premium that they must pay to shift that risk.

Outside the health insurance arena, CCBA has implemented that strategy by forming its own liability insurance captive and retaining as much risk as possible within that captive. Over time, CCBA has built up the reserves contained in that captive through premiums received by its members and has taken on more and more of the insurance risk traditionally assumed by commercial insurers. As those reserves have grown, CCBA has been able to return much of the premium to its members in the form of renewal credits, while still pricing the coverage at highly competitive levels. In 2007, CCBA was able to provide renewal credits amounting to over 25% of the normal premiums charged for its liability insurance programs.

The same solution can and will work within the health insurance arena, not only for CCBA and its members, but for other groups of small businesses. If, as the Mercer analysis indicates, that risk shifting cost is nearly 10% of the total cost of health insurance, CCBA or other organizations pooling groups of small businesses can reduce that cost to a very small number (or zero) over time, by simply pooling and retaining the risk. In order to do so, however, significant pools must be created (since short term fluctuations associated with risk retention for small groups would present too much risk) and other forms of cost disadvantages must be neutralized.

Employer-Provided Health Care Benefits and Cost Containment Incentives

While administrative costs and risk shifting premiums are two of the most important drivers of health insurance costs for the entire system, there are other important drivers, including provider costs. As noted in the Mercer data, "actionable" claim costs are another significant component of health insurance costs and another source of substantial disparity between small and large groups.

Based upon my discussions with major providers and other market participants, a major driver of unnecessary or avoidable claims costs (which may not all be captured in Mercer's estimate of "actionable" claims) is ineffective management of chronic disease. Those industry participants emphasize the importance and effectiveness of disease management programs, particularly for major chronic conditions like diabetes, heart disease and other similar conditions and believe that a large part of the treatment provided by the medical community would be unnecessary or less costly if patients with those chronic conditions would simply participate in the effective disease management programs. There is some debate about the quality of some of those programs, but there appears to be a consensus that effective programs are underutilized.

As is turns out, the data again shows a large gap between the experience of small and large businesses in this arena. Not only does the Mercer data reflect a significant actionable claim cap between large and small business, but a separate recent Mercer survey shows that utilization and availability of health and disease management programs as a part of large employer (over 500) programs is more that double the utilization in small employer programs.

This huge gap may have significant implications for both the cost of small business health care programs and the long term health of the small business workforce. On one level, the gap is somewhat surprising since employees at large and small businesses with chronic health conditions would seem to have roughly equal financial and non-financial incentives on their own to participate in and adhere to health management plans. As is widely recognized, at least one reason why formal health disease management programs are necessary is because employees (and in fact all of us) may need additional incentives to take the steps to remain healthy and avoid expensive treatment regimens resulting from poor management of chronic diseases, particularly when a third party payor system reduces the financial incentives for both the patient and the provider proactively to invest time and money in disease management.

It would appear that the driver of the gap must be the differences in the external (third party) disease management incentives provided to employees of large and small businesses. It is my speculation, based in part on discussions with industry experts, that the driver of that difference is the incentives provided to large employers by the self-funded, self-insured model, where the cost of ineffective chronic disease management is ultimately borne by the employer. The self-insured employer tends to adopt disease management strategies and provide employee incentives as part of the loss control programs that are central to any well-run self-insurance program. In contrast, for a small employer that is purchasing a fully-insured policy, the financial incentive to encourage or incent employees to manage chronic diseases is far more attenuated. Indeed, because insurer-provided health management programs may impose additional upfront premium charges, small employers may have disincentives to encourage aggressive chronic disease management, given their need to minimize upfront costs by eliminating "optional" features in insurance programs.

Key features of Effective Health Care Reform and the CHOICE Act

Based on the foregoing, our experience suggests that effective health insurance reform must have four significant characteristics: (1) it must eliminate or significantly reduce the disparity between opportunities for small and large employers, (2) it must create real opportunities for improved risk and administrative pooling across groups of small employers, (3) it must create opportunities for small employer risk retention, to reduce the cost of carrier risk shifting or create additional competition in the pricing of risks and (4) it must create the right type of incentives for effective chronic disease management programs and, more broadly, healthier behavior by all Americans.

In my opinion, of all of the legislation introduced or discussed thus far, a single bill, the CHOICE Act, seems to best combine all of those key features.

It recognizes that the largest driver of the uneven playing field, disparate state regulations that do not apply to large employer self-funded programs, is simply a product of core federalism principles that should not lightly be compromised. It thus requires that covered programs be fully insured and also comply with all applicable state laws concerning mandated coverage and other state insurance regulations. While that recognition of the prerogatives of the states will leave in place the administrative cost disadvantages that make pooling of coverage for multiemployer groups small businesses so difficult, the CHOICE Act proceeds to solve that disadvantage by providing an offsetting federal tax credit for the small business employer, provided that certain reasonable requirements are met (employer subsidies of a reasonable portion of the cost). Moreover, the second major required feature of programs complying with the CHOICE Act, inclusion of a wellness program, goes directly to the fourth objective outlined above—improvement in small business employee participation in chronic disease management.

After putting the small business cooperative program on a reasonable competitive footing from a cost perspective, the CHOICE Act proceeds to call for a quid pro quo which actually works as a second benefit, by both requiring and enabling formation of a cooperative and captive to reinsure substantial individual claims. One obvious rationale of that feature is to assure that catastrophic claims by individuals insured within the program remain covered and are not excluded because the carrier is unwilling to cover or provide affordable pricing for employers and their employees that present obvious and known risks (the "lazering" process that CCBA and its members have sometimes faced). At least as importantly, however, the cooperative requirements provide incentives and opportunities for small businesses and their trade associations or other partners to not only cover catastrophic claims, but to retain most of the risk associated with health insurance programs, by retaining all individual risks exceeding $10,000 annually.

Properly employed, the incentives provided by the CHOICE Act will also work to reduce many of the other costs disadvantages facing small businesses, by allowing formation of relatively large pools of lives relatively quickly. In CCBA's case, we believe that it would allow us to re-form our small bottler program within a very short period of time and to restore the competitive benefits that we were once able to provide to those bottlers, perhaps on even more favorable terms. We also anticipate that we can successfully extend the program into similar businesses with minimal additional work. Indeed, we believe that, over time, we will be able to make that program extremely attractive for even bottlers and other businesses that are not eligible for the full tax credit because they have between 100 and 500 employees (our captive-insured liability programs work very successfully for somewhat larger business). In those cases, we believe that we be able to provide more affordable insurance coverage and reduce the ranks of the uninsured without any major expenditure of federal tax dollars to support the particular medium sized businesses that might participate.

The Small Business Health Care Crisis and the Economic Crisis

Finally, I would note that the CHOICE Act approach has a number of other advantages and provides a number of collateral benefits that are not delivered as effectively by other proposed reform measures. The first two, and most important, of these benefits is that the CHOICE Act is (a) simple and (b) immediate in the way that it can be implemented. Unlike many other reform proposals, the CHOICE Act leaves in place both the workplace and the private insurance model for delivery of health care benefits. While there is room for debate as to whether those models are perfect, or even ideal, there seems to be little question that any reform that is dependent on a radically different model (e.g., individual insurance, single provider, etc.) will take years, or even decades, to fully implement. Likewise, the CHOICE Act is not dependent on a lengthy process of ground-up reform at the state and local regulatory level. In essence, it facilitates the adoption of the model that works reasonably well for big business (self-funded risk retention) and makes it more available to small business pools. In these troubled times, legislation that carries the promise of delivering more affordable benefits to small businesses in 2009-10, rather than 2013 or beyond, should be a central objective.

The other important collateral benefit delivered by the CHOICE Act is restoration of parity between small and large businesses. CCBA's mission is to create parity of opportunity and parity of cost for all of its members, so that small town fourth and fifth generation bottling companies can continue to exist and thrive, even when they compete with global multinational public companies. The single remaining gap that we have not been able to close is the health care gap and my small members continue to tell me that they are not able to offer the types of benefits that allow them to compete for employees with large public companies, including some of their Pepsi competitors.

I believe that elimination of that gap should be important not only to this Committee, but to the Congress and the nation as a whole. Last weeks' news, when a handful of public companies tried to dampen the impact of disappointing earnings reports with announcements of over 100,000 job cuts, should not be lost on any member of Congress. As is widely recognized, this economic slowdown will have a huge impact on employment, the size of which cannot currently be predicted. Small business is not only the engine of job creation in the U. S., but must also play a particularly large role in mitigating the Main Street impact of a Wall Street collapse, given the scope of the Fortune 500 job cuts that are well underway. Now, more than ever, Congress should act quickly to address the Hobson's choice facing small businesses—eliminate health care benefits to their employees or eliminate some of the employees themselves--by providing targeted help to the small business community. Relative to any other form of federal spending on health care, it is my view that such assistance is more likely to stimulate the economy by improving the competitiveness of the small business community.

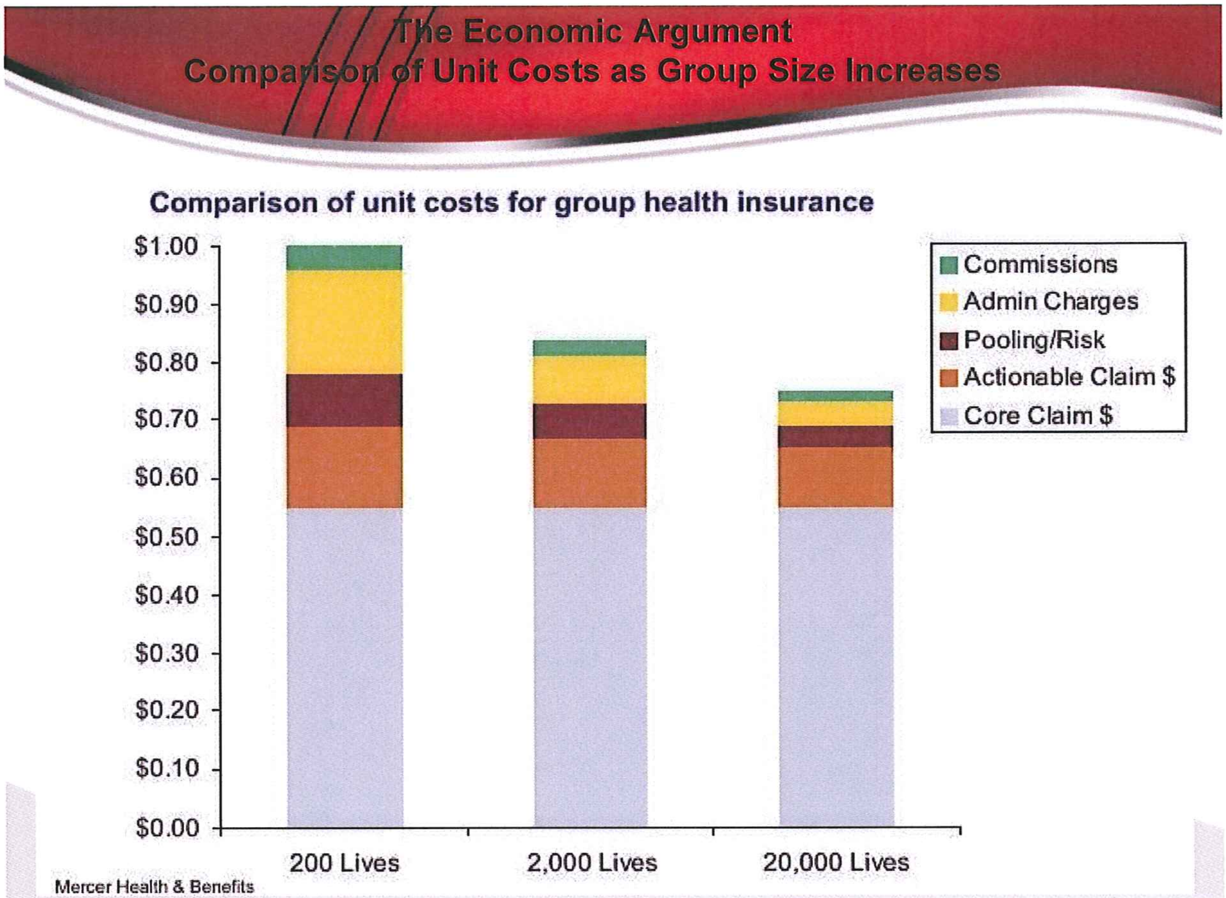
Conclusion

As a strong believer in the superiority of market-oriented, rather than public sector driven, solutions to policy challenges (all other things being equal), I would like to add a footnote to my comments that is directed at others that share that belief. The CHOICE Act does involve the investment of federal tax dollars (whether viewed as a tax credit or a subsidy) to the problem of declining access to affordable health benefits for our nation's small employers and their associates. That should not deter any fiscal conservative from providing their enthusiastic support to the Act, because it represents the type of investment that will deliver huge returns to the public because of the way in which it will affect the markets for the delivery of health care and health insurance.

As noted above, the cooperatives that it will "seed" will take billions of dollars in costs out of the system that are not reaching the hands of providers of health care services. By addressing the current imbalances between small and large employers it will place those employers on more equal footing in recruiting new employees and in competing in the marketplace for the goods and services that they produce and sell.

Moreover, the tax credits provided under the CHOICE Act are not, at their essence, incremental public expenditures. By significantly reducing the ranks of the uninsured, market-based reform (and federal spending) that empowers small business to provide quality health care benefits (including preventative care) will reduce the cost of uncompensated care by providers and will shrink total health care spending. Moreover, unlike many other type of public programs, which are unable to deliver a dollar in benefits to the intended targets because of the administrative costs associated with program administration, the CHOICE Act will require minimal administration and will drive market forces that will deliver tens or even hundreds of dollars in benefits to its targets for every dollar of tax revenues expended. In my view, it is a paradigm for the kind of federal spending that should be embraced, and not questioned, by fiscal conservatives.

Thank you again Madam Chairwoman and the Committee for the opportunity to share my views and the experience of CCBA and other similar trade associations in supporting the small business community in providing quality health care benefits.


The Economic Argument
Comparison of Unit Costs as Group Size Increases
Comparison of unit costs for group health insurance
$1.00
$0.90
$0.80
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Commissions
Admin Charges
Pooling/Risk
Actionable Claim $
Core Claim $
200 Lives
2,000 Lives
20,000 Lives
Mercer Health & Benefits

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